United States Court of Appeals

for the Second Circuit

APPELLANT’S BRIEF

15 U.S.C. §§ 78m and 78p, and that defendants failed to

75-7006

To be argued by
SIDNEY FELDSHUH

In The

United States Court of Appeals

For The Second Circuit

DAVID STIRLING, JR. and WILLIAM G. STIRLING,

Plaintiffs-Appellants,

vs.

CHEMICAL BANK, individually, and as Agent; THE CHASE MANHATTAN BANK, N.A.; MARINE MIDLAND BANK-WESTERN; MARINE MIDLAND BANK-ROCHESTER; LINCOLN FIRST BANK OF ROCHESTER (formerly LINCOLN ROCHESTER TRUST COMPANY); UNION COMMERCE BANK, FRANK BEATTY; JOHN J. IRISH; PAAVO PRIMA; "RICHARD ROE"; "MICHAEL ROE"; "MARTIN ROE"; "ALPHONSE ROE"; and "BILL ROE"; (quoted names fictitious, true names being unknown, the parties intended being officers and/or employees of the respectively named defendant banks, as co-conspirators, along with other co-conspirators, not herein named),

Defendants-Appellees.

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BRIEF FOR PLAINTIFFS-APPELLANTS

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 75-7006

DAVID STIRLING, JR. and WILLIAM G. TIRLING,

Plaintiffs-Appellants,

-against-

CHEMICAL BANK, individually, and as Agent: THE CASE MANHATTAN BANK, N.A.; MARINE MIDLAND BANK-WESTERN; MARINE MIDLAND BANK-ROCHESTER; LINCOLN FIRST BANK OF ROCHESTER (formerly LINCOLN ROCHESTER TRUST COMPANY); UNION COMMERCE BANK; FRANK BEATTY; JOHN J. IRISH; PAAVO PRIMA; "RICHARD ROE"; "MICHAEL ROE"; "MARTIN ROE";"ALFONSE ROE"; and "BILL ROE"; (quoted names fictitious, true names being unknown , the parties intended being officers and/or employees of the respectively named defendant banks, as co-conspirators, along with other co-conspirators, not herein named),

Defendants-Appellees.

APPELLANTS' BRIEF

PRELIMINARY STATEMENT

This is an appeal from a decision of the Honorable Dudley B. Bonsal, United States District Judge for the Southern District of New York and the order and judgment entered

pursuant thereto. The decision is reported at 282 F.Supp. 1146.

Plaintiffs-Appellants, David Stirling, Jr. and William G. Stirling ("the Stirlings") filed notices of appeal in this and three related cases as follows:

> David Stirling, Jr. and William G. Stirling v. Union Planters National Bank of Memphis, et al. 74 Civ. 66.
>
> David Stirling, Jr. and William G. Stirling v. First National State Bank of New Jersey, et al. 74 Civ. 64.
>
> David Stirling, Jr. and William G. Stirling v. First National Bank of Chicago, et al. 74 Civ. 65.

The foregoing cases, together with the instant appeal, have been assigned docket number 75-7006.

In a decision dated February 11, 1975, this Court dismissed the appeal 74 Civ. 66 as premature. Thereafter the Stirlings entered into stipulations with defendants in 74 Civ. 64 and 74 Civ. 65, dismissing those appeals as likewise being premature.

STATEMENT OF ISSUES

The following issues are presented to this honorable Court for review:

1. Must plaintiffs have purchased or sold securities of the Stirling Homex Corporation in order to acquire standing to maintain an action pursuant to the anti-fraud

provisions of the Federal Securities Laws?

2. Did the Revolving Credit Agreement and the financing statements issued pursuant thereto constitute the purchase and sale of securities or qualify plaintiffs as investors?

3. Did defendants' failure to file reports pursuant to Section 13(d) of the Securities Exchange Act of 1934 give rise to a federal cause of action which plaintiffs have standing to pursue?

4. Did defendants' failure to file reports pursuant to Section 16(a) of the Securities Exchange Act of 1934 give rise to a Federal cause of action which plaintiffs have standing to pursue?

STATEMENT OF THE CASE

Nature of the Case

This is an appeal from an order and judgment of District Judge Dudley B. Bonsal, dismissing plaintiffs' amended complaint.

The amended complaint alleged three causes of action in favor of plaintiffs individually and as representatives of a class composed of similarly situated shareholders of the Stirling Homex Corporation ("Homex"). The

first Court of this amended complaint alleged common law fraud through a plan and scheme whereby defendants sought to elevate themselves from unsecured to secured creditors. In the course of said plan and scheme plaintiffs were fraudulently induced to resign as officers and directors of Homex; Homex was forced by defendants into insolvency; and Homex securities lost substantially all of their value.

The second cause of action alleged violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b), Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5, and Section 17 (a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77q(a). Plaintiffs contend that defendants were control persons and as such had a duty to disclose material information; that defendants falsely represented that they would not call outstanding loans and would make additional loans to Homex and failed to disclose their intention not to forbear from calling loans and not to make additional loans; that these misrepresentations and nondisclosures resulted in artificially inflated market prices; and that as a result, plaintiffs and members of the class were damaged.

The third cause of action alleged that defendants were corporate insiders and control persons who were required to file reports under Sections 13 and 16 of the Exchange Act,

And of further import, is the "recognition"

15 U.S.C. §§ 78m and 78p, and that defendants failed to do so. Therefore, defendants did not disclose to plaintiffs, and other members of the class, the true facts regarding defendants' fraudulent plan and scheme. As a result, plaintiffs and other members of the class were unable to act in accordance with their best interests under the circumstances.

Proceedings Below

Defendants moved to dismiss the amended complaint on the ground that it failed to state a federal claim upon w hich relief could be granted and that without a viable federal claim, the district court was without jurisdiction to entertain the common law cause of action which was predicated upon pendent jurisdiction.

The district court found that plaintiffs failed to state federal claims upon which relief could be granted in courts two and three of the amended complaint. Consequently, the district court dismissed courts two and three for lack of a federal question and court one for lack of pendent jurisdiction.

Facts

Plaintiffs David Stirling, Jr. and William G. Stirling were officers and directors of Homex. The Stirlings were also holders of over 40% of Homex' common stock.

Homex was a public corporation, organized under the laws of the State of Delaware. The corporation was engaged in the business of manufacturing and installing modular housing with its principal offices located in Avon, New York.

As of July 29, 1971, Homex had borrowed on an unsecured basis from a banking consortium approximately $32,000,000. The banking consortium was composed of the banks named as defendants in this action in addition to the banks named as defendants in the related actions not the subject of this appeal. Subsequent to July 29, 1971, the banking consortium advanced additional monies on an unsecured basis so that on or about January 24, 1972 the banking consortium had advanced approximately $38,000,000, which debt was evidenced solely by unsecured notes.

Thereafter, defendants acting as principals and agents and in concert with other members of the banking consortium, initiated negotiations with Homex and its wholly-owned subsidiary, U. S. Shelter Corporation, for the announced purpose of increasing the Homex line of credit up to $55,000,000. Defendants' actual purpose in initiating said negotiations was to gain control of Homex and to elevate themselves to the position of secured creditors and, in fact, defendants never intended to advance any additional monies or forbear from calling the existing loans as represented.

prohibit all fraudulent schemes in connection

As part of defendants' fraudulent plan and scheme, they induced plaintiffs as representatives of Homex to execute and deliver financing statements, which statements when filed created a lien in favor of defendants and other members of the consortium upon Homex' assets. Furthermore, defendants' fraudulently induced plaintiffs to enter into a Revolving Credit Agreement which likewise elevated defendants to a position of secured creditors.

Thereafter, defendants fraudulently induced the Stirlings to resign as members of the Homex Board of Directors and as Homex officers, and to consent to the election of defendants' deputy as president of Homex.

The fraudulent inducements were made in the form of representations that if plaintiffs acquiesced to defendants' demands, then the consortium would forbear from calling outstanding loans and would advance additional monies up to a maximum of $55,000,000.

Notwithstanding the fact that plaintiffs met all of the consortium's demands by executing the financing statements; by entering into a Revolving Credit Agreement; by resigning from positions as officers and directors; by consenting to the election of defendants' deputy to the office of president of Homex; and by inducing one, Harold M. Yanowitch to resign his position as an officer and director of Homex, the consortium

failed to refuse to forbear from calling its loans and failed and refused to advance additional monies.

To the contrary, approximately one week after all of the foregoing demands were met, the consortium called its outstanding loans and thereby forced Homex into bankruptcy proceedings. Immediately thereafter, when members of the consortium learned that Homex was planning to file a petition pursuant to Chapter XI of the Bankruptcy Law, the consortium fraudulently induced Homex to file its petition under Chapter X of the Bankruptcy Law by fraudulently promising that additional monies would be advanced to the corporation in the event that a Chapter X petition was filed. In fact, Homex filed its petition pursuant to Chapter X but once again, no further monies were advanced.

The foregoing acts of the defendants, together with other acts constituted the plan and scheme whereby the defendants gained control of Homex and elevated themselves to the status of secured creditors. At no time did defendants intend to forbear from calling the loans and at no time did defendants intend to advance further monies.

ARGUMENT

POINT I

NO PURCHASE OF HOMEX SECURITIES BY THE PLAINTIFFS NEED BE ALLEGED FOR THEM TO HAVE STANDING UNDER SECTION 10(b) AND RULE 10b-5.

The district court held at p. 1151[1] that in order to maintain an action for violation of the anti-fraud provisions of the Federal Securities Laws, plaintiffs must have "... the status of purchaser or seller required by Birnbaum and progeny...". Plaintiffs assert that this holding is clear error in light of the evolution of the law regarding §10(b) and Rule 10b-5, since 1952 when Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), cert. denied 343 U.S. 956 (1952) was decided.

A succinct statement of the law, as it exists at this point in time, is that, to have standing with respect to Section 10(b) and Rule 10b-5, all plaintiffs need allege, in addition to damages, is fraud upon them as investors in connection with a securities transaction, even though they themselves, did not participate as an actual purchaser or seller in the transaction, so long as they were directly injured as a consequence thereof.

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1. Citations to the district court's opinion refer to the reported opinion at 382 F.Supp. 1146.

Supt. of Ins. v. Bankers L. & C. Co., 404 U.S. 6 (1971); S.E.C. v. National Securities, 393 U.S. 453 (1969); Eason v. GMAC, CCH Fed. Sec. L. Rep. ¶94,344 (7th Cir. 1973); Travis v. Anthes Imperial Ltd., 473 F. 2d 515 (8th Cir. 1973); Herpich v. Wallace, 430 F. 2d 792 (5th Cir. 1970); Crane v. Westinghouse Air Brake Co., 419 F. 2d 787 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970); Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967); Brod v. Perlow, 375 F. 2d 393 (2d Cir. 1967); Vine v. Beneficial, 374 F.2d 627 (2d Cir.), cert. denied, 389 U.S. 970 (1967); Ruckle v. Roto American Corp., 339 F. 2d. 24 (2d Cir. 1964); O'Neill v. Maytag, 339 F. 2d 764 (2d Cir. 1964); Heyman v. Heyman, 356 F. Supp. 958 (S.D.N.Y. 1973); Boggess v. Hogan, 328 F.Supp. 1048 (N.D. Ill., E.D. 1971); Neuman v. Electronic Specialty Co., CCH Fed. Sec. L. Rep. ¶92,591 (N.D. Ill. E.D. 1969); Commerce Reporting v. Puretec, 290 F.Supp. 715 (S.D.N.Y. 1968); Entel v. Allen, 270 F. Supp. 60 (S.D.N.Y. 1967). Also, see Note, "The Controlling Influence Standard in Corporate Mismanagement Cases", 86 Harvard L. Rev. 1007 (1973); C. L. Whitaker, "The Birnbaum Doctrine: "An Assessment", 4 Securities L. Rev. 290 (1972); Lowenfels, "The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5", 54 Va. L. Rev. 268 (1968); as well as the cases discussed in said Note and articles, and the sometimes voluminous footnotes thereto.

seek to find solace in the fact that the notes given by Homex

Therefore, plaintiffs now turn to the Agreement of April 15, 1972 (Appendix A hereto) which supplemented the Revolving Credit Agreements dated as of January 24, 1972, and variously referred to throughout the Amended Complaint herein.

Plaintiffs' argument is predicated upon the assumption that the Purchaser-Seller requirement for standing to assert a Section 10(b)/Rule 10b-5 claim is no longer existent. Subsequent analysis herein will be directed to presenting plaintiffs' claim in "classical", pre-*Bankers Life* and pre-*Eason* terms, and at that time the Revolving Credit Agreements and supporting documentation will be analyzed in terms of their constituting securities, and whether or not a purchase or sale thereof, or any other securities here involved, took place.

Viewing the plaintiffs as investors, it is manifest that they did all things within their power to give life to the Agreement of April 15, 1972. An examination of Appendix A hereto will clearly indicate the signatures of the plaintiffs, David Stirling, Jr., signing on behalf of Homex, and David Stirling, Jr. and William G. Stirling, both signing in their individual capacities.

Note, also, that at the time the Agreement of April 15, 1972 was signed, Homex was already in default under the terms of the Revolving Credit Agreement, and that the

plaintiffs were in effect (just as the plaintiffs in <u>Eason</u>) approaching the banks as investors in Homex rather than debtors, and were offering additional security for the bank loans to Homex.

It is also true (see paragraphs 6 and 7 of Appendix A) that the debtor, Homex, was also providing additional security. That, in and of itself, does not detract from the fact that the plaintiffs were investors and not debtors, and as such investors, they did, in truth and in fact, agree to pledge all of their then unencumbered Homex stock plus all presently encumbered Homex stock which subsequently would become unencumbered to the bank consortium in consideration for the consortium's agreement to allow Homex, while admittedly in default under the Revolving Credit Agreements, to pay a preferred dividend in April, 1972.

It is manifest that the Agreement of April 15, 1972, as well as the underlying Revolving Credit Agreements, constituted transactions involving securities, and that the defendants did behave, or so plaintiffs allege, in a fraudulent manner in respect to the securities transactions here involved, and that the plaintiffs and other Homex shareholders were injured as a direct consequence of defendants' fraud. <u>Bankers Life</u>, <u>supra</u>; <u>Eason</u>, <u>supra</u>.

Birnbaum has been attacked, defended, criticized and analyzed and, as previously stated, it is plaintiffs' position that its purchaser-seller limitation has finally been eliminated. However, and as will be demonstrated below, the case at bar both upon factual grounds and for policy considerations actually falls within the parameter of those cases which either followed or affirmed Birnbaum, and it is to these cases that the plaintiffs herein have recourse in the presentation of their position, should this Court hold that said purchaser-seller requirement is still existent.

As this Court is well aware, by 1967, the Securities and Exchange Commission, the regulatory agency charged with the responsibility for enforcing the Securities Laws, had retreated from the position it initially had taken with respect to Rule 10b-5,[2] and, as amicus curiae, in Vine, supra, stated that it was the Commission's position that a plaintiff need not be an actual purchaser or seller, so long as the Securities Acts had been violated and plaintiff's stock had decreased in value.

Not desiring to burden this Court with plaintiffs' analysis of the evolution of Section 10(b) and Rule 10b-5, a detailed analysis of the above referred to authorities will not be presented. But the Court is respectfully referred to the above cited authorities for a thorough analysis of the purpose

(2) SEC Securities Exchange Act Release No. 3230 (May 21, 1942).

behind as well as the evolution of the so-called Birnbaum doctrine.

It is evident from the number and type of "exceptions" to the Birnbaum doctrine that various courts, in appropriate cases - and this is an appropriate case - have not hesitated to find standing for investors where they have suffered damages as a result of a fraud committed in connection with a securities transaction.

Exceptions to the Birnbaum doctrine have been variously characterized as "contract" cases, situations of "forced purchase or sale", "aborted transactions", "injunctive suits", "corporate mismanagement" and "derivative."

Capsulized, these exceptions moved step by step away from the strict holding in Birnbaum - which, and to prevent a flood of corporate mismanagement suits in the federal courts, required a completed purchase or sale, and further that the plaintiff had to have been the purchaser or seller of the security, as to which the fraud had been practiced - to situations where first, all that was found necessary for standing was a contract for the purchase or sale of a security, rather than an actual purchase. Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967); see Mader v. Armel, 402 F. 2d 158 (6th Cir.), cert. denied, 394 U.S. 930 (1969); Whitaker, supra, at 298-306.

The courts have moved further away from the strict Birnbaum requirements in other cases where the transaction involved no actual market place purchases or sales and created the class of exception characterized as "forced" or "involuntary" purchases or sales. Typical of this category are Vine, supra; Crane Co. v. Westinghouse Air Brake Co., supra, and Boggess v. Hogan, supra.

An example of the "aborted transaction" exception to the Birnbaum doctrine can be found in another Northern District of Illinois case, i.e. Neuman v. Electronic Specialties Co., supra.

Another example of a transaction where the absence of an actual purchase and sale were found not to be a bar to standing under Section 10(b) was the case of Mutual Shares Corp. v. Genesco, Inc., supra, where the plaintiffs were seeking an injunction.

In the recent case of Heyman v. Heyman, supra, Judge Bauman, of the Southern District of New York, found that a plaintiff had Section 10(b) standing despite the fact that she was neither a purchaser nor a seller and did not fit within either the "forced seller" or "injunctive" exceptions to the Birnbaum doctrine.

The facts in Heyman can be summarized briefly as follows:

The beneficiary of a testamentary trust, funded with the proceeds of the sale of securities in a closely-held family corporation, was virtually forced to consent to the sale of said securities, at what she now alleges was less than their fair value.

The parallels to the case at bar are significant.

> "[S]he is merely the beneficiary of a trust funded by the sale of those shares. Although not the seller, she was the one who immediately stood to gain or lose by the sale; it was for her benefit ... that the sale was made. In cases such as Birnbaum and Mutual Shares, it must be remembered, plaintiffs were not only non-sellers; they were not involved, directly or indirectly, in a sale. The sales in each case, had been concluded between the defendants and third parties. Here, plaintiff's connection with the sale is much closer; although plaintiff was not the nominal seller, she was the beneficiary of the sale. That is a nexus missing in the line of cases which follow Birnbaum. In conferring standing on this plaintiff, the court is mindful of the admonition of our Court of Appeals in Crane v. Westinghouse Air Brake [citation omitted] that the purchaser/seller requirement be interpreted so that the broad design of the 1934 Act, to prevent inequitable and unfair practices in securities dealings not be frustrated by novel or atypical transactions." Heyman v. Heyman, supra, at 965.

The present case presents even a stronger case because the plaintiffs were directly involved in the April 1972 transaction for the benefit of Homex and under the facts herein

said Agreement (Appendix A hereto) actually constituted, if not an outright sale of said securities it did, in §13(d) terms, constitute a transfer or sale of the beneficial ownership of the plaintiffs' securities involved in the transaction.

This, coupled with the fraud alleged in connection with the securities transaction in Homex stock, clearly places this case within the standing requirement met in Heyman, supra.

Judge Bauman's analysis in Heyman, supra, applied the same type of analysis as Chief Judge Robson in Boggess v. Hogan, supra, wherein he analyzed the Birnbaum doctrine.

Briefly summarized, Boggess was both a derivative and individual class action suit by a minority shareholder of Unicoa, alleging Section 10(b) and Rule 10b-5 claims with respect to the defendant's fraudulent conduct and scheme to acquire control of United, another corporation, of which they were former shareholders. An initial tender offer by Teledyne to United was resisted by United's management and was rejected by United's shareholders. Teledyne then entered into a secret deal with two of United's directors, whereby the latter would support a second Teledyne tender offer in return for Teledyne's buying their personal interests in an unrelated corporation.

The Court found an unquestioned breach of a fiduciary duty by United's management, as well as the fact that once the take-over had been completed, Teledyne, which had merged United into Unicoa, basically drained United's assets to support other Teledyne activities, and further depressing the market price for Unicoa by not paying any dividends.

This was another case where the court stated quite clearly that while none of the class of plaintiffs involved in the transaction was an actual seller of securities, the plaintiffs nevertheless had Section 10(b) standing consistent with cases such as Birnbaum and SEC v. National Securities, supra.

In summary, the Court concluded that:

> "This conduct allegedly resulted in substantially altering the assets and business of United, thereby diluting the equity interests of its minority shareholders. This Court is therefore of the opinion that the alleged conduct of the Teledyne defendants violated the letter and spirit of Section 10(b) and Rule 10b-5." Boggess v. Hogan, at page 1053.

Again, the parallels to the case at bar are most striking, i.e., fraudulent course of conduct, breach of fiduciary duty and effect upon equity interests of shareholders not to mention the impact the banks' scheme had upon the market value of all Homex securities.

And of further import, is the "recognition" by the Seventh Circuit that:

> "While indicating its nominal recognition of the Birnbaum rule, the United States Court of Appeals for the 7th Circuit has broadly defined those persons eligible to maintain an action under Section 10(b) and Rule 10b-5." Boggess v. Hogan, supra, at 1051.

This is a direct signal that the Seventh Circuit, as is the case with other circuits, finds that Birnbaum is not to be a straitjacket, inflexibly to be applied. Indeed, the emerging area emphasizes the "persons eligible" rather than, and nigh in place of, the "purchaser-seller" rote doctrinaire formula.

Whether this Court chooses to characterize the transactions involved in the case at bar as "purchases or sales," or forced participation in a purchase or sale, or ascribes to this transaction other labels which are exceptions to the Birnbaum doctrine, or limits its holding to this particular factual situation and captions its holding by another label, it is plain that the manipulation, deception and fraudulent practices engaged in by the defendant Banks and their co-conspirators certainly are of the type which the Securities Act was designed to prevent. Such conduct by the defendants and their co-conspirators, and the consequent injury to the shareholders' equity in Homex, create cognizable personal claims under Section 10(b) of the 1934 Act and Rule 10b-5 and Section 17 of the 1933 Act.

The issue confronting this Court is the same one which arises time and time again in the area of Section 10(b) litigation, namely, whether the defendants have structured their fraudulent scheme or transaction in such a manner as to fall without the ambit of the protections of the 1934 Securities Act, as confined by the Birnbaum doctrine and its recognized exceptions. The mere fact that there are exceptions to Birnbaum is strong evidence of the fact that the Courts were willing to achieve a basic purpose rather than to follow Birnbaum strictly.

When faced with the problem of resolving the issue of plaintiffs' standing under Section 10(b) and Rule 10b-5, the Courts constantly have admonished that substance and not form was to control, and that the basic legislative intent of the 1934 Act was to be carried out without regard to form.

The purpose of Section 10(b) and Rule 10b-5 is to:

> "... protect investors from deceptive schemes, no matter how ingenious". Travis v. Anthes Imperial Ltd., supra, at 522.

In refusing to dismiss a complaint merely because the alleged scheme or transaction did not involve the type of fraud that usually is associated with the sale or purchase of securities, Judge Kaufman, writing for a unanimous bench, stated:

> "We believe that §10(b) and Rule 10b-5 prohibit <u>all</u> fraudulent schemes in connection with the purchase and sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws." <u>Brod v. Perlow</u>, <u>supra</u>, at 397.

The Supreme Court's mandate is quite clear:

> "§10(b) bans the use of any deceptive device in the 'sale' of any security by 'any person'. And the fact that the transaction is not conducted through a securities exchange or an organized over-the-counter market is irrelevant to the coverage of §10(b)... Section 10(b) must be read flexibly, not technically and restrictively .... [W]e read §10(b) to mean that Congress meant to bar deceptive devices and contrivances in the purchase or sale of securities and whether conducted in the organized market or fact to face." <u>Bankers Life</u>, <u>supra</u>, at 10-12.

> "Section 10(b) and Rule 10b-5 together constitute one of the several broad antifraud provisions contained in the securities laws... Whatever the terms 'purchase' and 'sale' may mean in other contexts [where] an alleged deception has affected individual shareholders' decisions... the broad antifraud purposes of the statute and the rule would clearly be furthered by their application to [such] situations[s].... This view does no violence to the statutory language." <u>SEC v. National Securities</u>, <u>supra</u>, at 466-467.

There is absolutely no <u>statutory</u> or <u>policy</u> reason why standing under Section 10(b) and Rule 10b-5 must be limited to schemes or transactions which employ the commonly used devices of tender offers or mergers or <u>directly</u> involve a purchase or sale. So long as a securities transaction was involved and said transaction was fraudulent with a consequential impact upon the plaintiffs, there is no reason, especially

where corporate mismanagement (Birnbaum) is not involved, for not granting the plaintiffs herein standing under the Section and Rule.

To deny plaintiffs standing in this case not only would be to fly in the face of reality, but also would totally disregard the dictates above outlined and allow the conspirators to evade the application of the 1934 Act to their fraudulent scheme, simply because they used a novel or a typical device.

This is especially so when the plaintiffs were among the very targets of the banks' and their co-conspirators' scheme, which had as one of its cardinal purposes, the creation of an utterly false sense of security designed to cause plaintiffs either to hold, rather then to sell, the securities they already had purchased, or, to purchase Homex securities when they otherwise might not have, all to their eventual detriment.

In any event, the efficacy of the last remaining vestiges of Birnbaum has been seriously questioned by this Court's recent decision in Schlick v. Penn-Dixie Cement Corp., C.C.H. Fed.Sec. L. Rep. ¶94,853, where Judge Oakes, speaking for the Court, said at p. 96,876:

> "It can truthfully be said ... that '... Birnbaum survives significantly only for the buyer-seller requirement, which has been much reduced by other decisions.' " (citations omitted)(emphasis supplied).

The reduction of the buyer-seller requirement has come about as a result of enlightened judicial interpretation enlarging the orbit of Section 10(b) and Rule 10b-5 in order to assure protection for all members of the class for whose special benefit the statute and accompanying rule were enacted.

The Stirlings emphatically urge that under the circumstances at bar, they are members of that class and therefore this honorable Court should cast aside for all time the remaining Birnbaum restrictions and find that the Stirlings have indeed averred claims cognizable under the Federal Securities Laws.

POINT II

THE REVOLVING CREDIT AGREEMENT AND THE FINANCING STATEMENTS FRAUDULENTLY OBTAINED BY DEFENDANTS CONSTITUTE THE PURCHASE AND SALE OF SECURITIES.

The Revolving Credit Agreement (see ¶ 11 of the Amended Complaint), its supporting documents and the supplementing Agreement of April 15, 1972 (Appendix A), constitute the purchase of securities by defendants and the sale of securities by plaintiffs.

The revolving Credit Agreement consisted of the basic Agreement itself which set forth the various participation in the credit, promissory notes, a Security Agreement and Assignment, a Pledge Agreement, UCC Form 1's and the subs equent supplementing Agreement wherein, *inter alia*, the plaintiffs pledged all of their Homex common stock to the conspirators.

Without attempting to place all the plaintiffs' reliance upon any one of the above-enumerated documents, it must be recognized that any one or more of said above-described documents, as a matter of law, can be construed and determined to be a "security", as the term has been defined time and time again by the Courts. *Tcherephin* v. *Knight*, 389 U.S. 332 (1967); *SEC* v. *Howey Company*, 328 U.S. 293 (1945).

Lest the defendant banks and their co-conspirators seek to find solace in the fact that the notes given by Homex to the banks under the Revolving Credit Agreement were basically short-term notes, with maturities of less then nine months, plaintiffs would rely on cases such as Sanders v. John Nuvean & Co., Inc., 462 F.2d 1072 (7th Cir. 1972); and Anderson v. Francis I. Du Pont, 291 F. Supp. 705 (D. Minn. 1969). In Sanders, the 7th Circuit Court quoted from SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963), to the effect that federal securities legislation should not be construed technically and restrictively, but flexibly, to effectuate their remedial purposes, and in a case dealing with a promissory note, with the maturity not exceeding nine months, held that said note was a security, and as such, was not excepted from the anti-fraud provisions of the 1934 Securities Act.

Should the defendants and their co-conspirators seek to attack the Revolving Credit Agreement itself, as not being a security, reference is made to the case of U.S.A. v. Austin, 462 F.2d 724 (10th Cir. 1972), wherein a loan commitment letter was held to be a security and Lehigh Valley Trust Co. v. Central National Bank of Jacksonville, 409 F.2d 989 (5th Cir. 1969), wherein the Court specifically found that a loan participation agreement between two banks constituted a security under the Securities Act of 1934 for §10(b) purposes.

Again it is emphasized that the April 15, 1972 Supplementary Agreement (Appendix) not only constituted in and of itself a "security" under the above and like authorities, it also constituted a separate and distinct <u>transaction</u> involving the "sale" of Homex common stock by the plaintiffs to the defendant banks.

There can be no real argument that under ¶5 of the April 15, 1972 Agreement, together with:

i) The acknowledged default of Homex under the Revolving Credit Agreements, as stated in the Agreement;

ii) The absolute inability of Homex to cure said default - as firmly established by the course of subsequent events which culminated in the defendant banks calling their loans and Homex filing under Chapter X of the Bankruptcy Act;

iii) The inability of the plaintiffs to cure the defects for or on behalf of Homex; and

iv) The fact that, at least as far as the plaintiffs were concerned, the Agreement was not executory (Plaintiffs signed it and delivered it to Chemical, as agent, to obtain the signatures of the other banks).

there was a "sale" of plaintiffs' Homex common stock sufficient to satisfy the <u>Birnbaum</u> standing requirement to assert a §10(b)-Rule 10b-5 claim and in connection with that securities transaction defendants defrauded plaintiffs and plaintiffs were

injured thereby.

Just touching the parameters of the banks' relationships with Homex, it becomes evident that, prior to Homex' entry into the Revolving Credit Agreement; the ancillary documents required to place it into effect; and the April 15, 1972 Supplementary Agreement, the plaintiffs' securities represented interests in a corporation with sizeable assets.

Subsequent to the defendants' successful completion of their fraudulent plan and scheme, a secured lien apparently had attached to all of the corporate assets and by the time defendants' scheme had come full circle, plaintiffs' shares not only had little or no market value, they represented shares in a bankrupt corporation undergoing liquidation in the hands of a Chapter X Trustee.

Furthermore, the transaction in which the Revolving Credit Agreement, and its ancillary documents, were executed, constitutes another purchase and or sale - depending upon from which side of the transaction it is viewed - of a security; said transaction involved a fraudulent scheme, device or design, and as a result thereof, the plaintiffs herein were injured.

Another method or way of finding a sale or purchase, if one must be found, is to recognize that there is inherent in the normal securities transaction three (3) basic investment decisions: (i) to purchase; (ii) to hold; and (iii) to sell.

If it be recognized that the investment decision to hold a security is as important as the decisions to purchase or to sell and it be further recognized that the decision to hold can, just as the other two decisions, be influenced by information available in the market place, then the dichotomy between "to purchase or sell" and "to hold" is but a verbal distinction lacking a substantive difference or basis. If, because of fraud, the information in the market place is incorrect, investors will make "wrong" decisions, be they to purchase or sell or hold, and be injured thereby.

Hence, no viable distinction can be drawn between the investment decisions to purchase or to sell, on the one hand, and to hold, on the other. Therefore, it makes no sense to allow standing under §10(b) where the decision has been to purchase or sell but not when the decision was to hold.

That must be the rationale underlying the "injunctive" case exception where the plaintiffs who still held their shares were granted standing under §10(b). Mutual Shares Corp. v. Genesco, Inc., supra.

That being the fact, under the facts and circumstances of the case at bar, this Court may decide that holding satisfied the standing requirement of §10(b) or that holding constitutes an aborted sale and allow standing under the exception to the Birnbaum doctrine. Neuman v. Electronic Specialty Co., supra.

only an obligation under Section 13, but also to file under

That, in simplest form and in broad brush, is the statement of plaintiffs' Section 10(b) and Rule 10b-5 claim.

It matters little to plaintiffs whether this Court will choose to couch its decision herein in terms which will follow the *Birnbaum* doctrine, although plaintiffs claim that the purchaser-seller requirement of *Birnbaum* has been expunged from the Federal securities law, *Easton*, *supra*, however, what is important to the plaintiffs is that this Court recognize that they have standing under Section 10(b) and Rule 10b-5.

POINT III

THE DEFENDANTS' FAILURE TO DISCHARGE THEIR DUTY TO FILE REPORTS PURSUANT TO SECTION 13(d) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, CONFERS A CAUSE OF ACTION UPON THE PLAINTIFF FOR WHICH THEY ARE ENTITLED TO RECOVER.

In their third cause of action, plaintiffs stated that the defendant banks violated Section 13 of the Securities Exchange Act by failing to file the statements required by Section 13(d) and Rule 13d-1 promulgated thereunder.

In pertinent part § 13 provides:

> "(d)(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to Section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement ...as the Commission may ... prescribe as necessary or appropriate in the public interest or for the protection of investors....
>
> (3) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for the purposes of this subsection.

of Director of Homex and President of U.S. Shelter Corporation,

> (4) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer." (emphasis added).

At the time the conspiracy among the nine banks was formed, Rule 13d-1 in relevant part provided:

> "Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to Section 12 of the Act, ... is directly or indirectly the beneficial owner of more than 5% of such class shall, within 10 days after such acquisition, send to the issuer of the securities at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing the information required by Schedule 13D (§240. 13d-101)."

In short, Section 13(d)(1) and Rule 13d-1 establish an obligation to file a Schedule 13D statement when (a) any "person" who, (b) after "acquiring directly or indirectly" (c) the "beneficial ownership" of, (d) any class of equity security registered pursuant to Section 12 of the Act, (e) is directly or indirectly the beneficial owner of more than 5% of such class.

A. <u>Any "Person"</u>

As has been noted § 13(d)(3) provides "when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding or disposing of securities of an issuer, such person or group shall be deemed a 'person' for the purposes of this subsection". The term "person", as used in Section 13(d), was recently construed by the Second Circuit Court of Appeals in <u>GAF</u> v. <u>Milstein</u>, 453

F.2d 709, Cert.Den.406 U.S. 910 (1972). The Second Circuit held a family group, who pooled their interest as part of a conspiracy to acquire control of a corporation, was a "person" within the orbit of Section 13(d).

In GAF v. Milstein, Judge Kaufman stated that Section 13(d) was intended to bring to public attention every rapid accumulation of securities which might represent a potential shift in corporate control. Assuming that the facts alleged in the complaint are true, as indeed the Court must when construing a motion to dismiss, Vine v. Beneficial Finance Co., supra at 633; Herpish v. Wallace, supra at 802, it is abundantly clear that the nine banks who conspired against the plaintiff constituted a "group" and thus, as a "person", was subject to the provisions of Section 13(d).

B. "Acquiring"

The statute refers to "acquiring" directly or indirectly the beneficial ownership of securities, but nowhere explicitly defines the concept of "acquisition" as used in Section 13(d). Although plaintiffs are mindful of Judge Learned Hand's warning "Not to make a fortress out of a dictionary.", Cabell v. Markham 143 F2d 737, 739 (2d Cir.) aff'd., 364 U. S. 404 (1945), some light is shed by Webster's Third International Dictionary. It tells us that "to acquire" means "to come into

possession (or) control". Under this definition, the defendant banks would be deemed to have "acquired" direct or indirect beneficial ownership of Homex stock no later than April 15, 1972, the date they, acting in concert, got the Stirlings to sign the Supplemental Agreement. It is at least at that moment that they possessed and controlled the Corporation. It can not be argued that they did not use this power to force the plaintiffs and others from their officerships and directorships with the Corporation; that they did not, pursuant to the April 15, 1972 Supplemental Agreement, have the power to control production; or that they did not authorize the April preferred dividend. Consequently, it is clear that their unlawful activities brought them within the ambit of the statute.

The legislative history, as well as the purpose behind Section 13(d), support this proposition. Any residual doubt over the soundness of this is obviated by the following clear statement appearing in both the House and Senate Reports accompanying the Williams Act:

> "[Section 13(d)(3)] would prevent a group of persons who seek to pool their voting or <u>other interests</u> in the securities of any issuer from <u>evading</u> the provisions of the statute because no one individual owns more than 10 percent (5 percent after the 1970 amendments) of the securities. <u>The group would be deemed to have become the beneficial owner, directly or indirectly, of more than 10 percent</u> (5% after the 1970 amendments) <u>of a class of securities at the time they agreed to act in concert. Consequently, the group would be required to file the information called for in Section 13(d)(1) within 10 days after they agreed to act</u>

together, whether or not any member of the group had acquired any securities at that time." S. Rep. No. 1711, 90th Cong. 1st Sess. 8 (1967); H.S. Rep. No. 1711, 90th Cong. 2d Sess. 8-9 (1967); U.S. Code Cong. & Admin. News, p. 2818. (Emphasis added). See, also, L. Loss, Securities Regulations 3664 (1969).

In light of the statutory purpose as construed in GAF v. Milstein, supra, the mere formation of the consortium with its Revolving Credit Agreements, without more, constitutes an acquisition of all the securities owned by its individual members. Moreover, after an acquisition which results in the beneficial ownership of more than 5% of a regulated class of equity securities, there is an obligation to file a Schedule 13D within 10 days thereafter. Failure to file within 10 days after an understanding is reached, constitutes a violation of Section 13(d). Water & Wall Associates, Inc. v. American Consumer Industries, Inc. CCH Fed. Sec. L. Rep. 93, 943 (D.N.J., 1973). No argument can possibly be made that such reports were ever filed.

In reaching its decision in GAF v. Milstein, the Second Circuit found itself in disagreement with the interpretation that the Seventh Circuit gave to the term "acquisition". In Bath Industries, Inc. v. Blot, 427 F2d 97 (7th Cir., 1970), the Seventh Circuit stated that an agreement to act in concert must relate to the acquisition of additional shares. Even though

the Second Circuit rejected the position advanced in Bath Industries and held that Section 13(d) must be construed in light of its purpose to alert the market place to every large accumulation of securities which might represent a potential shift in corporate control, the acquisition concept of Bath Industries is here satisfied as well as that of GAF.

Of emphatic importance is the means and method by which the nine banks sought to and did acquire control of Homex.

In addition to the defendant banks' other activities and ownerships of Homex common stock, the Supplemental Agreement, inter alia, provided:

> "5. David Stirling and William G. Stirling will pledge to the Agent, as agent for the Banks, all unencumbered shares of capital stock of the Company owned by them (and all encumbered shares now owned by them which may hereafter cease to be encumbered); such pledge to be terminated when all defaults by the Company have been cured."

As has previously been pointed out this so-called pledge agreement on April 15, 1972 was not a mere naked pledge. To the contrary and of urgent import is its first page where the unusual acknowledgment of at least one existent default by Homex under the Agreement as of January 24, 1972 is set forth in haec verba. The pledge agreement, in unmistakable terms, provides:

> "The Company acknowledges that the unpaid principal amount of the Notes outstanding under the Credit Agreement exceeds the Borrowing Base (as defined in Article IX(b) of the Credit Agreement) and that pursuant to Section 2.02 thereof, the Company is required to repay the Notes in an amount equal to the amount of excess. The Company also acknowledges that the Company is in default under certain other provisions of the Credit Agreement." (Emphasis Added).

At once, the Court can readily perceive that by this April 15, 1972 agreement, the banks were not merely pledgees. They were, in fact, a group of "two or more persons" acting together "for the purpose of acquiring, holding or disposing of securities". Their intention to do such is plainly revealed by the recital of default because it was that already existing default which gave to them the power, to be exercised at their whim and caprice, to take absolute hold of the pledged securities. Their interest under these circumstances transcended from that of possession solely for security to an acquirer, whose interest in the security has now become finite and fixed, and where in the circumstances of this case mere formality would convert their title from that of a pledgee to an absolute owner. They were the beneficial owners of said securities for § 13 purposes, see ¶ "C" <u>infra</u>.

It is in the posture possessed by the banks that they became persons acting as a group "for the purpose of acquiring, holding or disposing of securities of an issuer". No

dispute exists that the holdings of the plaintiffs by far exceeded the 5% limitation set forth above. Thus, the device of acquisition, now accomplished, becomes manifested by the banks' control of the office of President of Homex wherein but fifteen days after the date of this so-called pledge agreement they mandated the resignation of the then president and put one of their nominees in his place.

By reason of the foregoing, it is now clear that the statutory purpose underlying Section 13(d) leads unmistakably to the conclusion that the defendant banks "acquired" plaintiffs' stock and with it "control" in the statutory sense the moment they decided to work together for the purpose of elevating themselves from the position of unsecured to secured creditors and in effecting such purpose "acquired" from plaintiffs <u>after default</u> their unencumbered shares albeit under the guise of additional security.

C. <u>"Beneficial" Ownership</u>

Rule 13 d-3 sets forth the standard for determining whether a person is or becomes directly or indirectly the beneficial owner of equity securities. In pertinent part, Rule 13 d-3 provides that:

"In determining, for the purposes of Section 13(d) ... whether a person is directly or indirectly the beneficial owner of securities of any class, such person shall be deemed to be the beneficial owner of securities of such class which such person has the right to acquire through the exercise of presently convertible securities, or otherwise." (Emphasis added).

In short, Rule 13 d-3 was and is designed to incorporate within its scope all devices, no matter how structured or camoflaged or atypical to acquire beneficial ownership in an equity security.

Paragraph 5 of the so-called Pledge Agreement, whereby the plaintiffs pledged to the defendant banks all shares of Homex capital stock owned by them, given the already acknowledged default, was in fact not a pledge but in reality the transfer of ownership out of plaintiffs to the defendant banks. This was so because neither the banks nor anyone else could reasonably expect that the $38,000,000.00 then owing to the banks and due three months later could possibly be paid unless the defendant banks honored their promises of additional funding which they never intended to do in the first place.

D. "Equity Securities Registered under Section 12"

There is no dispute whatsoever over the fact that Homex was a public corporation, whose preferred and common

stock constituted equity securities registered pursuant to Section 12. Therefore, the securities are undeniably within the purview of Section 13(d).

E. "5% Ownership"

As noted above, the equity securities over which the defendants banks acquired control, through the devices employed in the pledge agreement which gave them direct or indirect beneficial ownership thereof, comprised nearly 50% of the Homex common stock issued and outstanding.

In light of the foregoing, it is abundantly clear that the defendants' failure to file the reports required by Section 13(d) gave rise to a cause of action. Dienstag v. Bronsen, CCH Fed.Sec. L. Rep. 92,274 (S.D.N.Y. 1968). As shareholders injured as a result of the defendants'failure to file, the plaintiffs have standing to assert a claim upon which relief may be granted. Grow Chemical Corp. v. Uran, 316 F. Supp. 891 (S.D.N.Y. 1970). Accordingly, it is clear that the district court erred in finding that plaintiffs failed to state a federal claim pursuant to Section 13(d).

POINT IV

DEFENDANTS'FAILURE TO DISCHARGE THEIR DUTY TO FILE REPORTS PURSUANT TO SECTION 16(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, GIVES RISE TO A CAUSE OF ACTION WHICH THE PLAINTIFFS HAVE STANDING TO PURSUE.

In plaintiffs' third cause of action, they also allege that the defendants violated Section 16 of the Securities Exchange Act by failing to file the reports required of them as control persons and insiders.

Section 16(a) states at the outset:

> "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

Directors, officers and "beneficial owners" of 10 percent or more of any class of corporate equity security in corporations whose shares are listed on a national securities exchange or registered under Section 12 of the Securities Exchange Act are required by Section 16(a) of the Act to file reports with the Securities and Exchange Commission concerning their stockholdings and changes in their stockholdings in such corporations. The purpose of this section is to give "full and prompt publicity" to such changes in order to prevent trading on inside information by persons in control of publicly held corporations or charged with the administration of corporate affairs - and hence charged with the administration of

other people's money. H.R. Rep. No. 1383, 73 Cong., 2d Sess. (1934).

A vital corollary to the foregoing reporting requirements is found in Section 16(b) of the Act, which provides for the recovery by the corporation of so-called "short-swing" trading profits made by insiders in the purchase or sale of securities to which Section 16(a) applies. In brief, Section 16(b) requires an insider to turn over to his corporation any profit realized by him from any purchase and sale, or any sale and purchase, of its equity securities within any period of less than six months. This section was merely intended by Congress to be a "crude rule of thumb", (Senate Comm. on Banking and Currency, Stock Exchange Practices, S. Rep. No. 1455, 73rd Cong., 2d Sess. 55 (1934), to effect the legislative purpose to prevent the unfair use of information by certain persons. (Frome & Rosenzweig, Sales of Securities by Corporate Insiders, Practicing Law Inst., 1972, P. 109).

Thus, the statutory prophylactic underlying the enactment of Sections13, 16(a) and 16(b) was to prevent the unfair use of inside information by control persons. The crucial point hereat then becomes what is control.

In the sense of the 1934 Securities Act control of Homex can be defined in terms of both (i) actual control - who actually ran Homex, who made the decisions on a day to day basis. See, e.g. North Country Uranium & Minerals, Ltd., 37 S.E.C. 608 (1957); or (ii) power to control, See, e.g. The Chicago Corp., 28 S.E.C. 463 (1948).

Applying either criteria it is clear that the defendant banks controlled Homex during the period of time herein and as such they individually or collectively constituted control persons or a control group which had both the actual power to go so far as to dictate and cause top level management changes, the appointment of their nominee to the Presidency of Homex and the right (clearly stated in ¶2 of the Supplemental Agreement of April 15, 1972) to control Homex's production runs as well as the obligation of control persons under §16(a) to file reports with at least the Securities and Exchange Commission and Homex - which latter obligation they avoided.

The complaint and the April 15, 1972 Supplemental Agreement make abundantly clear that the defendants possessed the power to effect changes of the greatest significance, not the least of which occurred when they forced the plaintiffs to relinquish their officerships and directorships, and to deputize persons of the banks' own choosing to serve as officers and directors of Homex. By so doing, they incurred not

only an obligation under Section 13, but also to file under Section 16(a).

"Officers" of any corporation which has registered an equity security with the Securities and Exchange Commission pursuant to Section 12 of the Act, are required to file the reports called for by Section 16(a). For purposes of Section 16(a), Rule 3b-2 provides that the term "Officers" includes the corporation's "president, treasurer, secretary, comptroller, and any other persons who perform for an issuer . . . functions corresponding to those performed by the foregoing officers.

Likewise, persons who sit as "directors" must also file the reports called for by Section 16(a). The term "director" is defined similarly in Section 3(a)(7) of the Act as "any director of a corporation or any persons performing similar functions with respect to any organization, whether incorporated or unincorporated."

Akin to the broad impact of these reporting provisions is the locking concept of "deputization" enunciated by Blau v. Lehman, 368 U.S. 403 (1962), and Feder v. Martin Marrietta Corporation, 406 F. 2d 260 (2d Cir. 1969), cert. denied, 396 U.S. 1036 (1970), wherein "deputization" occurs when an outsider uses to advantage any information

acquired by his "deputy" in the latter's role as director or officer. (See: Wagner, Deputization Under Section 16(b), 78 Yale, L.J. 1151, 1170 (1969).

At this point it must be made emphatic that when the banks put in their man as President of Homex, by forcing the resignation of the plaintiff, William G. Stirling, the banks had their "deputy" fully clothed with control and managerial powers. At least from that moment, if not sooner, the responsibilities and burdens of such authority and control fell upon the banks. Their endeavors to escape from those obligations, while fully enjoying in their own self interests the benefits of their "deputy", must and should be turned aside by the Court. In sum, defendant banks herein utterly failed to respond to the duties imposed upon them by §16, and thereby that branch of the third cause of action of the Complaints is fully sustained.

Moreover, the defendants' "control" and "ownership", through nominees and others of Homex common stock, has now been dramatically revealed through bank documents and otherwise in a hearing conducted by the Chapter X Trustee on May 6, 1974. It appears that the Banks in truth and in fact had another "deputy" in Homex top management beginning long prior to March or January, 1972 and continuing through July 11, 1972, the date of filing the Chapter X Petition.

That man was C.W. Marshall, who held the positions of Director of Homex and President of U.S. Shelter Corporation, the wholly-owned financing subsidiary of Homex. Marshall served as the defendants' "man" at Homex and was the conduit of information and watchdog for the Banks. Thus, defendants have multiple deputies on the Homex board. See, Blau v. Lehman, supra.

CONCLUSION

FOR ALL OF THE FOREGOING REASONS, IT IS RESPECTFULLY URGED THAT THE DISTRICT COURT'S ORDER DISMISSING THE AMENDED COMPLAINT MUST BE REVERSED AND THAT THIS CAUSE MUST BE REMANDED TO THE DISTRICT COURT FOR PRE-TRIAL PROCEEDINGS AND TRIAL.

Respectfully submitted,

FELDSHUH, WEINBERGER & DERFNER
Attorneys for Plaintiffs-Appellants,
David Stirling, Jr., and
William G. Stirling
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Sidney Feldshuh

Donald A. Derfner,

Of Counsel

STIRLING HOMEX CORPORATION
1150 East River Road
Avon, New York 14414

April 15, 1972

<u>Revolving Credit Agreement dated as of January 24, 1972</u>

To: Participating Banks

Dear Sirs:

Please refer to the Revolving Credit Agreement dated as of January 24, 1972 (the "Credit Agreement") by and among Stirling Homex Corporation (the "Company"), each of you and Chemical Bank ("Chemical") as your Agent (the "Agent").

The Company acknowledges that the unpaid principal amount of the Notes outstanding under the Credit Agreement exceeds the Borrowing Base (as defined in Article IX(b) of the Credit Agreement) and that pursuant to Section 2.02 thereof, the Company is required to repay the Notes in an amount equal to the amount of excess. The Company also acknowledges that the Company is in default under certain other provisions of the Credit Agreement.

However, to induce you to forbear at this time from exercising your rights under the Credit Agreement by reason of the defaults on the part of the Company (including your right to compel repayment pursuant to Section 2.02) and to

Appendix A

allow the Company to utilize proceeds received by the Company for working capital, the Company agrees as follows:

1. The Company will submit to the Banks, within ten (10) days from the date hereof, pro forma balance sheets through July 31, 1972 with respect to the Company's Receivables Borrowing Base and Outstandings (in addition to the financial information required to be furnished by the Company pursuant to the terms of the Credit Agreement), in order to enable the Banks to review the status of matters at the expiration of each 30-day period.

2. The Company will, in no event, commence production of modules in connection with any project unless prior to the commencement of production the Agent has reviewed the applicable contract, proposed financing and such other matters as the Agent shall deem appropriate with respect to such project and shall have given prior written approval to the Company.

3. The Company will submit to the Agent a by-weekly letter (on the 15th and 30th of each month, commencing on April 30, 1972), signed by the Chairman or Executive Vice President of the Company, with respect to every project in process and setting forth in detail with respect to each such project the processing and/or work performed during the period covered by the letter to advance the project closer to the point of completion.

4. The Company will, within a reasonable period

of time enlarge its Board of Directors to include at least four (4) outside Directors.

5. David Stirling and William G. Stirling will pledge to the Agent, as agent for the Banks, all unencumbered shares of capital stock of the Company owned by them (and all encumbered shares now owned by them which may hereafter cease to be encumbered); such pledge to be terminated when all defaults by the Company have been cured.

6. The Company will execute and deliver to the Agent, as agent for the Banks, a first mortgage covering (i) the land, buildings and improvements owned by the Company located in Avon, New York, and (ii) other unencumbered land owned by the Company.

7. The Company will guarantee the obligations of its wholly-owned subsidiary, U.S. Shelt[illegible] Corporation, under the Credit Agreement dated as of January 24, 1972, between U.S. Shelter Corporation and Chemical.

8. The Company agrees that, anything contained in Section 1.02 of the Credit Agreement to the contrary notwithstanding, commencing April 3, 1972, the Notes shall bear interest at a rate equal to 2% per annum above the prime commercial rate of the Agent from time to time in effect.

9. The Company will, pursuant to Section 5.08 of the Credit Agreement, submit to audits by (i) the Mortgage and Real Estate Department of the Agent and (ii) Merritt &

Harris, Inc., 110 East 42nd Street, New York, New York.

10. The Company will present for the consideration of the Banks, not more than 90 days from the date hereof, a new credit extension proposal which might be followed subsequent to July 31, 1972.

11. The Company agrees that (i) all matters in connection with the transactions contemplated hereby shall be satisfactory to the Agent and to special counsel for the Banks, (ii) the Company shall bear all expenses in connection with such transactions and (iii) the Company shall furnish such additional documents and other matters as may be required in the judgment of the Agent and special counsel for the Banks to effect the transactions contemplated by this proposal.

12. The Company makes this proposal upon the express understanding that notwithstanding the acceptance thereof by the Banks, the Banks do not waive any default by the Company, whether now existing or hereafter arising under the Credit Agreement (including the right to compel repayment pursuant to Section 2.02 thereof and the right at any time hereafter to accelerate the maturity of the Notes in accordance with Article VII thereof) and, except to the extent that the Credit Agreement may be amended by the transactions contemplated hereby, all of the terms, covenants and conditions of the Credit Agreement shall remain in full force and effect.

David Stirling and William G. Stirling have signed this letter to confirm their agreement, as provided in Paragraph 5 hereof, to pledge the unencumbered shares of capital stock of the Company owned by them.

Very truly yours,

STIRLING HOMEX CORPORATION,

by [signature]
Chairman

Attest:

[signature]
Secretary

[signature]
David Stirling

[signature]
William G. Stirling

Accepted:

CHEMICAL BANK,

by [signature]
Vice President

THE CHASE MANHATTAN BANK, N. A.,

by

Vice President

FIRST NATIONAL BANK OF CHICAGO,

by

____
Vice President

MARINE MIDLAND BANK-WESTERN,

by

____
Vice President

MARINE MIDLAND BANK-ROCHESTER,

by

____
Assistant Vice President

LINCOLN ROCHESTER TRUST COMPANY,

by

____
Vice President

UNION COMMERCE BANK,

by

____
Vice President

FIRST NATIONAL STATE BANK OF
NEW JERSEY,

by

____
Vice President

UNION PLANTERS NATIONAL BANK,

by Franklin H. [illegible]
Assistant Vice President

CHEMICAL BANK, as Agent,

by John J. [illegible]
Vice President

AFFIDAVIT OF SERVICE

Re: 75-7006
Stirling v. Chemical Bank

STATE OF NEW JERSEY :
: ss.:
COUNTY OF MIDDLESEX :

I, Muriel Mayer , being duly sworn according to law, and being over the age of 21 upon my oath depose and say that: I am retained by the attorney for the above named Plaintiffs-Appellants .

That on the 21st day of March , 1975, I served the within Appellants' Brief in the matter of Stirling v. Chemical Bank , upon (see attached list)

by depositing two (2) true copies of the same securely enclosed in a post-paid wrapper, in an official depository maintained by the United States Government.

Muriel Mayer

Muriel Mayer

Sworn to and subscribed before me this 21st day of March 1975.

Lorraine Leotta

A Notary Public of the State of New Jersey.

LORRAINE LEOTTA
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires April 13, 1977.

AFFIDAVIT OF SERVICE

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